

Memo

ANDERSEN

To The Files
From Thomas H. Bauer
Date November 2, 2001
Subject Chewco Investigation

- CONFIDENTIAL -

October 26, 2001 I received a call from Rodney Faldyn and Ryan Siurek regarding formation of Chewco in 1997. Faldyn inquired about the requirements of EITF 90-15 for outside equity in an SPE if the investors include employees. I replied that the SPE needs to be capitalized with 3% of outside equity exclusive of the employee and that such conclusion is consistent with previous advice given on Chewco and more recently on LJM. Siurek acknowledged that LJM equity was grossed up for the percentage of Andy Fastow in the LJM transaction. Faldyn then advised that he had learned that Chewco may not have the requisite equity and inquired as to the accounting impact. I advised that the SPE would fail to qualify and the sponsor of the SPE would consolidate Chewco. Faldyn said he would meet with Rick Causey to discuss further and asked that I remain available. (Attached as Exhibit I is documentation prepared in 1997 upon initial advice given to Enron regarding its proposed Chewco structure.)

On October 27, 2001 I was asked to attend a meeting with Causey and Faldyn regarding Chewco. Also present at the meeting were Deb Cash and Dave Duncan. Causey presented a diagram of the Chewco transaction which he said had been constructed upon discussion with Ben Glisan. (Glisan is now treasurer of the company and was the principal accounting transaction support representative for Enron at the time of the transaction.) This diagram which was prepared by me from Causey's presentation is attached as Exhibit II.

Based upon the information presented, the group identified the following issues which would require further analysis:

- Did the Chewco partnership in fact have the requisite 3% of capital exclusive of any employee involvement?..

Based on information presented it was not possible to determine how much of Michael Kopper's contribution was included in the \$115,000 equity strip. (At the time of formation in 1997 we advised Enron that the 3% of outside equity must be exclusive of any employee involvement.) We were also advised by Causey that one of the other investees was Bill Dodson, a nonemployee, who's the business and personal partner of Kopper. We advised additional information about the relationship between Kopper and Dodson would be necessary to ascertain whether Dodson would be considered a related party.

- Was the Barclay's equity strip residual equity at risk as required by EITF 90-15?

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Requested by Tom Bauer

Causey advised that Glisan indicated that, upon buyout of Chewco in the first quarter of 01, Sonar received a distribution of approximately \$10 million. We discussed that if Glisan's connection was correct, the size of the distribution relative to Barclay's smaller distribution may indicate that Barclay's equity was disproportionate and perhaps in substance debt.

- Does Sonar control Chewco by virtue of a consent agreement from Big River?

Per Causey, Glisan made reference to a consent agreement which provided Sonar the right to vote Barclay's shares of Chewco. Depending upon the terms or collateral of the consent (e.g. withdrawal rights, etc.) Sonar may be deemed to control, thereby invalidating the governance criteria.

I advised Causey and the group that we had never been provided access to any document beyond the amended JEDI partnership documents that were created upon the Chewco transaction. We requested Chewco documents at the time of the transaction, but were advised by Glisan that the documents were those of a third party and Enron does not have access to such documents. I advised Causey and the group that access to such documents would be necessary to answer the items raised. Causey reiterated that at the present time, he has seen no factual support for the items discussed above.

At that point, Faldyn indicated that he had been told that a memo exists within the treasury department from Kopper to accounting instructing Enron as general partner in JEDI to direct future distributions to Chewco from JEDI after some specified date to the attention of Lee Fastow at a home address. Lee Fastow is the wife of Andy Fastow and previously worked at Enron in the treasury department. Causey stated that he is unaware of any interest that Fastow or his wife may have in Chewco and therefore it is unclear why distributions would be sent to Lee. We requested that Causey gather information regarding the instructions and any subsequent cash disbursements that were executed pursuant to the instructions, if any. We asked that Causey inquire as to access to Chewco documents and related documents so we can perform additional audit procedures.

On November 2, 2001, Andersen received a set of documents related to Chewco from Wilmer & Cutler. Deb Cash and I reviewed the Chewco documents and constructed a diagram of ownership based upon our review as set forth in Exhibit III. This review of the transaction identified the following issues:

- The interest by Barclay's was in the form of a yield certificate which defines Big River and Little River as borrowers and requires a yield slightly above LIBOR.
- I reviewed a two page letter agreement dated December 30, 1997 between JEDI and Chewco which provided for a distribution to Chewco of approximately \$16 million of which \$10 million was to be paid to Enron as a guarantee fee on debt of Chewco and approximately \$6 million to be deposited in reserve funding accounts of Big River and Little River. Based upon a review of other formation documents it appears that the deposit was a condition upon funding of the Barclay's certificate. As a consequence, a question arises as to whether the \$11 million contributions by Barclay's was funded in part by a distribution from JEDI. Therefore Barclay's contribution would be a net \$5 million which would be significantly below the 3% required.

On the evening of November 2, 2001 I was requested to attend a meeting with Mike Patrick, Alan Quaintance, Jim Brown, and Cris Sherman also from Andersen were Deb Cash, Patty Grutzmacher, Kimberly Scardino, Don

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Holley and Kate Agnew. Patrick stated that the purpose of the meeting was to seek our guidance on analysis of Chewco and LJM transactions and to compare notes on what Andersen had done to date. Patrick stated that he and others in the meeting had not begun any review and did not yet have access to documents. Such documents were to be presented on Saturday morning, November 3. I advised the group that we had reviewed the Chewco documents provided and identified, among other issues, the two items discussed above. I stated that we were continuing our analysis and had not formed conclusions at that time. I encouraged the company to review the certificate agreements and letter agreement and form their own conclusion. I added if the company concluded that the transaction met all the requisite capitalization tests after review of these documents, we would like to have a discussion as to the basis of their conclusions.

On the evening of November 3, 2001 I received a call from Patrick to attend a meeting to discuss the Chewco transaction. Patrick advised that he had met with inhouse counsel, Vinson & Elkins and Glisan and believed the transaction didn't result in a failed SPE. Dave Duncan and I attended this meeting. Present were Mike Patrick, Jim Brown, Cris Sherman, and Rick Causey. Subsequent to the commencement of the meeting others joined the discussion from time to time, Christina Mordant, inhouse legal counsel, Ron Astin, Vinson & Elkins Counsel, and Wes Colwell, North American Chief Accounting Officer. We discussed the following:

- Ron Astin commented that he believed the equity certificates were in fact equity within a legal definition and that the certificate holders had rights with respect to voting, and limiting the voting ability other parties, far greater than a typical debt agreement. I advised that to comply with SPE equity requirement the third party equity would be required to be equity in form and substance.
- Causey indicated that he was not sure that Dodson should be considered a related party. Mordant stated that Texas State Law doesn't legally recognize such relationships. I advised that I believed for accounting purposes, the assessment of whether Dodson was a related party would have to consider factors in addition to the legal factors to develop a conclusion.
- I inquired as to the group's response to the impact of the letter agreement dated December 30, 1997 referred to above. They replied they had not found such a document in their materials. We assisted the group with a search of the documents in the room, and located the agreement. Glisan, Mordant, and Astin each stated that they had never previously seen this agreement and were unaware of its existence. I inquired of Glisan as to the business purpose of this agreement. He said he did not know. I asked Glisan why Jeremy Blackman would have been the authorized party to sign such an agreement and he replied "that is a good question". I presented the accounting implications of the agreement which could reduce the 3% net equity as discussed above. Mordant presented an argument as to why the agreement should not alter the investors right to the capital account which I could not comprehend. Causey, Brown, Patrick, Glisan, Astin and Mordant then left the meeting to pursue this matter further. Later, Brown and Patrick returned to the meeting and stated that Glisan concluded that the transaction failed the criteria. I asked if this Enron's final conclusion and Patrick indicated he did not know.

On November 4, 2001 we were asked by Causey to work with Enron employees to assess the effect Enron Financial Statements assuming Chewco was a failed SPE. During that process we were presented a copy of Chewco's unaudited financial statements from Mark Lindsey. Mark Lindsey said he had received these from

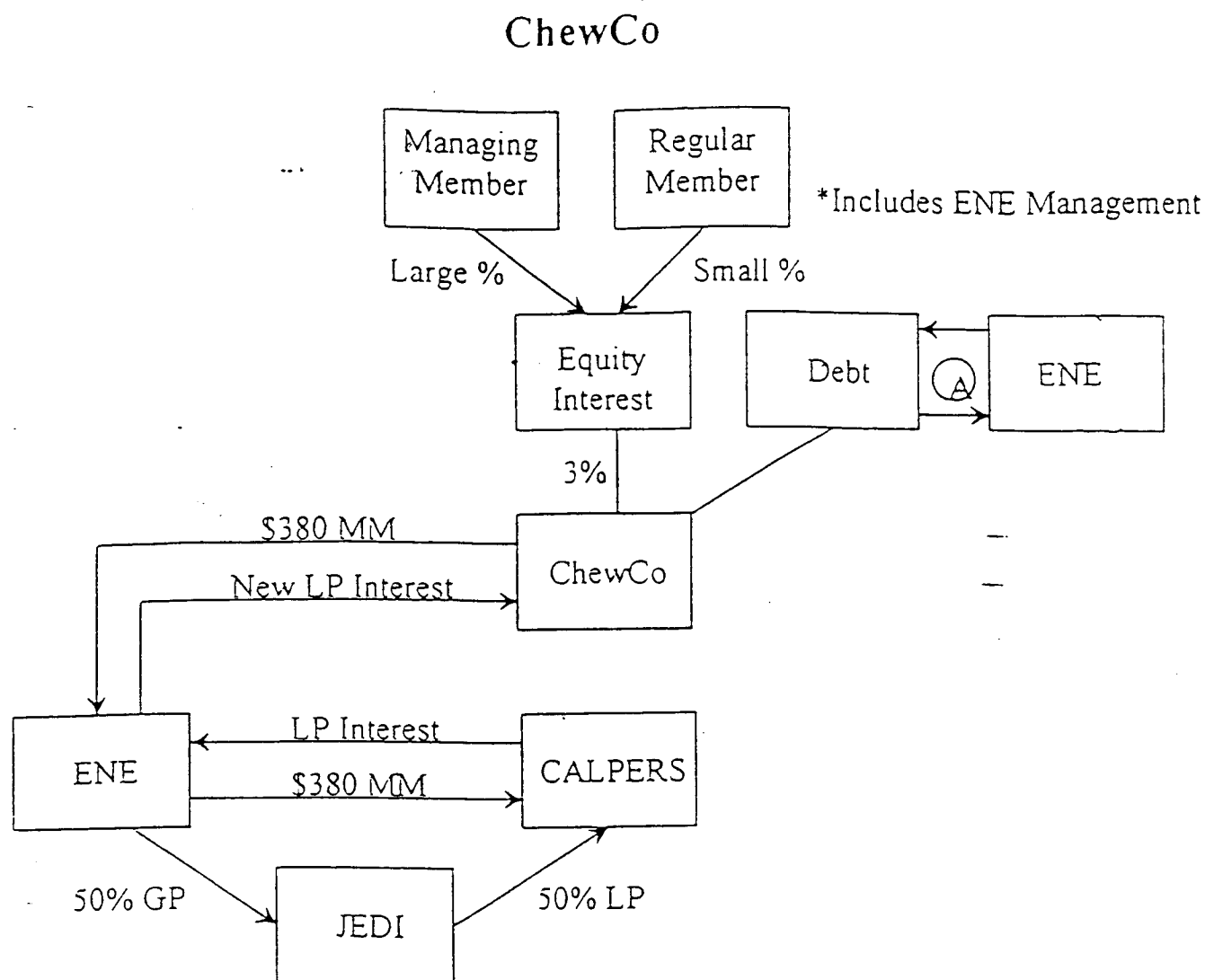
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Shirley Hedler in the funds management group. Mark said he had not previously seen the Chewco financial statements or knew of their existence.

We completed our analysis regarding the impact of the adjustment and attended a meeting Sunday evening whereby the company presented its estimate of the effect on previously reported net income. We advised Causey that we had not audited these estimates and the complexity of the JEDI agreement would require significant additional analysis to develop a more precise estimate of the impact.

Cc: Nancy Temple

Attachments



A Enron to provide guarantee on ChewCo debt for a fee or to provide ChewCo with loan.

Per discussion with John Stewart, ChewCo can qualify as an SPE and exist off the balance sheet of JEDI as a limited partner with Enron as the guarantor of debt or with Enron as the debt provider. However, the following conditions should apply.

- 1) The loan/guarantee from Enron to ChewCo should be at market.
- 2) The loan/guarantee from Enron to ChewCo should be executed under customary terms and conditions.
- 3) The equity holders (Managing Members and Regular Members) of ChewCo should have first risk of loss (i.e., be subordinate to the debt holder.)
- 4) Since the equity holders of ChewCo include a small percentage of Enron management, ChewCo will maintain 3% equity exclusive of these members and in no case shall the Enron Regular Members control ChewCo.

Chewco

Exhibit II

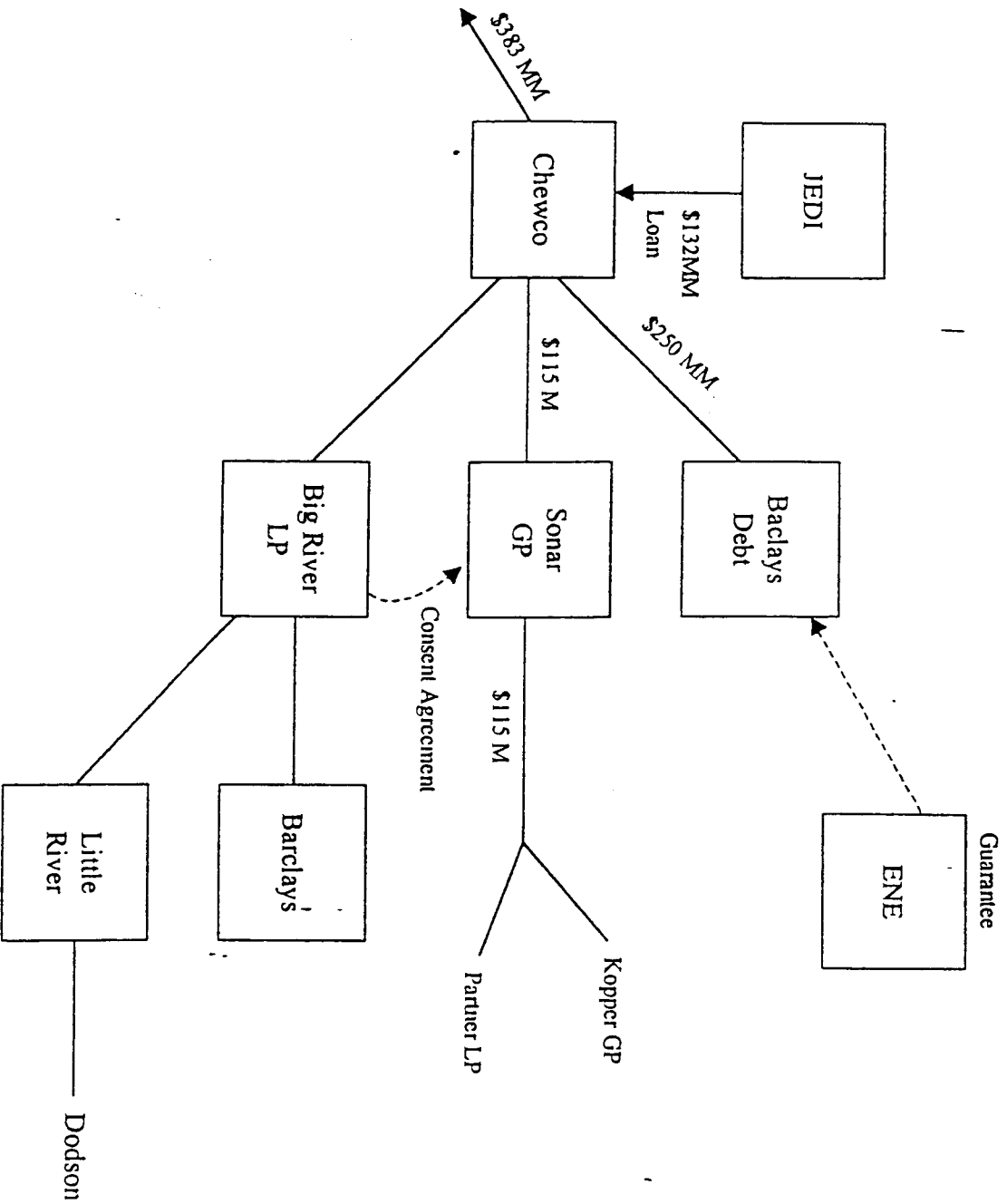


Exhibit III

